No. 94-1239

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1994

FULTON CORPORATION,

Petitioner,

V.

JANICE H. FAULKNER, SECRETARY OF REVENUE,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

PETITIONER'S RESPONSE TO RESPONDENT'S MOTION TO DISMISS THE WRIT

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STATEMENT OF FACTS

This action involves a state statute that taxes shareholders on the value of their stock more lightly when the corporation pays income tax to North Carolina on a higher percentage of its income (because a higher percentage of its payroll, property and sales is in the

state). Fulton Corporation[1] contends that this regime facially discriminates against interstate commerce. The Secretary contends that the income tax paid by the local corporations is a "compensating tax" that justifies the facial discrimination, that it is appropriate to protect local folk from "double taxation" in this manner, and that *Darnell v. Indiana*, 226 U.S. 390 (1912) is controlling and permits such a regime. The issues presented in the Brief for the Petitioner include:

> whether *Darnell* is factually controlling or has continuing validity;
>
> whether *Darnell* and the North Carolina taxing scheme involve a successful compensating tax defense, in view of the fact that in neither case is there an intrastate burden for which the heavier tax on foreign corporations' stock compensated;
>
> whether the compensating tax defense applies here by its terms;
>
> whether a compensating tax defense can be successful when the tax fails the internal consistency test applied in Commerce Clause cases;
>
> whether taxes on shareholders and on their corporation can be aggregated in making the internal consistency analysis.

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[1] Rule 29.1 Statement: Petitioner Fulton Corporation states that it has neither a corporate parent nor a corporate subsidiary.

Fulton filed this action over four years ago. Under the North Carolina tax statutes it had no pre-deprivation remedy by which to contest the constitutionality of the intangibles tax and was forced to pay the tax and sue for refund. It had to carefully make its claim for refund within the short period of 30 days after paying the tax, as required by North Carolina for refund claims based on illegality of the tax. N.C.Gen.Stat. §105-267; Pet. Brief App. 14a. Fulton lost in the trial court and won an interim victory, after two years of litigation, in the Court of Appeals. A year and a half later, the North Carolina Supreme Court reversed. As the litigation proceeded throughout 1992, 1993 and 1994, Fulton continued to pay the tax, which discriminates against interstate commerce; so did tens of thousands of other North Carolina taxpayers in amounts totaling more than $50,000,000 yearly.

The North Carolina General Assembly was considering repeal of the intangibles tax while Fulton's petition for writ of certiorari was pending before this Court. That repeal occurred shortly after the Court issued its writ.

Fulton brought to the Court's attention in its brief on the merits served on May 30, 1995 that the intangibles tax statute at issue was repealed after this Court granted its writ. In section E of the Statement of Facts (p. 8 of the Brief for the Petitioner), Fulton further informed the Court of the following points:[2]

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[2] For the Court's convenience, that section of the brief for the Petitioner is reproduced in the Appendix hereto.

1. The repeal will first apply to returns that would be due in 1996. [That is, North Carolina collected and retains the intangibles taxes due for 1994 on April 15, 1995, three days before the repeal, and continues to enforce the intangibles tax by audit and assessment for prior open years.]

2. The repeal does not affect the tax year at issue in this action, 1991.

3. The repeal does not address or satisfy Fulton's claim in this action, which is for a refund of tax paid for 1991, or Fulton's refund claims for later years, or the refund claims of thousands of similarly situated North Carolina taxpayers for 1992, and particularly 1993 and 1994 intangibles taxes on stock. [Taxes for these two years became due after the decision of the North Carolina Court of Appeals in this action alerted taxpayers generally that the tax is unconstitutional. Many tax return preparers in the state regularly undertook to assist their clients by submitting timely refund claims for intangibles taxes paid thereafter in 1994 and 1995.]

4. The case is not moot, nor is the importance of the legal issues upon which this Court issued its writ of certiorari diminished.

The Secretary of Revenue on June 13, after filing of Brief for the Petitioner, moved to dismiss the writ as improvidently granted, agreeing that the case is not moot.

ARGUMENT

A. This Court Cannot Allow States to Follow a Pattern or Practice of Collecting Unconstitutional Taxes, and When Review by This Court Seems Imminent, To Repeal the Taxes Prospectively, and Keep All Taxes Collected by Avoiding Review by This Court.

The Secretary's motion at fn. 1 asserts that the Court's grant of the writ did not motivate the repeal. This acknowledges an understanding that this Court would look unfavorably on an effort to maximize illegal taxation by waiting until the last minute to repeal the illegal tax, thereby collecting it as long as possible, and avoid this Court's review.

The sequence of events in this case and particularly the timing of the repeal strongly suggest that it was the spectre of this Court's intervention and of possible resulting substantial tax refunds that contributed to the legislation.

Although this Court on rare occasions, and normally on its own motion, has dismissed its writ as improvidently granted when, among other facts, the statute in question was repealed, such dismissal is particularly inappropriate for this case.

This case is one of a large group recently before this Court that involve efforts by states to retain the proceeds of an unconstitutional tax. The Court should adhere to its strong line of decisions holding firm on the duty of states to provide adequate remedies for illegal

taxes and not to play games with taxpayers' rights under the United States Constitution.

The Court has repeatedly rejected state ploys to retain the fruits of unconstitutional taxes. First, Florida claimed that it had no obligation at all to rectify an unconstitutional tax. But in *McKesson v. Div. of Alcoholic Beverages*, 496 U.S. 18 (1990) the Court ruled that states that do not provide a pre-deprivation remedy must provide a meaningful, clear and certain, post-deprivation remedy for unconstitutionally collected taxes, either by refund to disfavored taxpayers or by assessment of favored taxpayers to produce equality in taxation.

Next, Virginia argued that it could give purely prospective relief. In *Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993) the Court ruled that once it applies a determination of unconstitutionality to one state taxpayer its determination should be applied retroactively to all other similarly situated taxpayers, who should receive meaningful backward-looking relief.

Finally, Georgia sought to make the remedial path more difficult after this Court found its tax to be unconstitutional. In *Reich v. Collins*, 115 S. Ct. 547 (1994) (involving a short statute of limitations akin to that in N.C.Gen. Stat. §105-267) the Court ruled that a state cannot "bait and switch" remedies for unconstitutional taxes.

These and other decisions of this Court in recent years illustrate that states frequently attempt to protect their treasuries from the loss of unconstitutionally

collected taxes and that this Court has consistently headed off such attempts. By repealing the statute and moving to dismiss the writ North Carolina presents an innovative method of attempting to retain unconstitutionally collected taxes. If the Court grants this motion, this case will provide a roadmap allowing states to be relatively unconcerned about the constitutionality of their taxes, as they will know that they can repeal them prospectively when review by this Court appears possible, and pay no refunds.

The State of North Carolina has a particularly questionable record in regard to retaining illegally collected taxes. As noted above, it already has the extremely short thirty day statute of limitations for refund claims based on illegality of the tax, and as noted below it does not allow class claims for refunds, thus placing substantial practical and financial hurdles in the way of taxpayers who would contest the constitutionality of taxes that are not large for any one taxpayer. Its record of avoiding refunds of taxes illegally collected from federal retirees is an impressive example of the difficulties faced by North Carolina taxpayers who contest unconstitutional North Carolina taxes.

This Court ruled unconstitutional a state's taxation of pensions of federal retirees while exempting the pensions of its own retirees in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989) on March 29, 1989. In response, North Carolina collected the illegal tax due on April 15, 1989, prospectively repealed its discriminatory scheme for taxing federal retirees, and enacted an ineffective future tax credit for 1988 taxes

paid by federal retirees. It paid refunds of only about $9 million to only about 12,000 of more than 90,000 federal retirees (who paid over $40 million in taxes for 1988), who managed to submit refund claims within 30 days after paying their 1988 taxes in the spring of 1989. Brief in Opposition to Petition for Writ of Certiorari in *Swanson v. State*, USSC No. 93-1882, p. 6; Appendix to Petition for Writ of Certiorari in No. 93-1882, pp. A-169 and 173. North Carolina paid no refunds for earlier years and did not honor a class refund claim for 1988 taxes, under a decision of the North Carolina Supreme Court refusing to permit such a class refund claim. *Swanson v. State*, 335 N.C. 674, cert. denied, 115 S. Ct. 662 (1994). Furthermore, of the 23 states with discriminatory schemes similar to the one in the *Davis* case, North Carolina was possibly the only one that did not provide a judicial or suit settlement remedy to the class of federal retirees.

Having escaped relatively unscathed from the *Davis* case illegality, North Carolina has been emboldened to try once again to avoid refund of illegal taxes. The Court should not countenance the state's latest effort to sidestep the consequences of collecting an impermissibly discriminatory tax.

B. The Case Retains the Same Issues of Importance for which This Court Granted Its Writ.

The motion incorrectly states that "the question on which the Court granted review is of no continuing importance in North Carolina." It is of importance to Fulton's refund claims for the year at issue in this action

and later years and to the similar claims made individually by thousands of other North Carolina taxpayers under advice of tax professionals in the state. After the June 15, 1993 decision of the Court of Appeals most tax return preparers in North Carolina knew that recovery of intangibles taxes on stocks was a possibility and many major preparers routinely made demand for refund of intangibles taxes on stocks within the statutorily allotted time period in 1994 and 1995.

Furthermore, the broader significance of this action is not limited to states with intangibles taxes. It affects every taxing regime that employs a scheme to prevent alleged "double taxation" of local business by providing a tax benefit to local business and thus discriminating against out of state business. It affects every state court that might rely on *Darnell v. Indiana*, 226 U.S. 390 (1912) as authority for such discrimination under a compensating tax theory. It affects every state court that might rely on the North Carolina Supreme Court decision to ignore this Court's internal consistency test when a compensating tax is (incorrectly) found.

The authorities cited by the Secretary are not compelling. One involved a statutory amendment that retroactively gave the petitioner the right sought. *Morris v. Weinberger*, 410 U.S. 422 (1973). One involved multiple grounds for dismissal aside from repeal of the statute. *Triangle Improvement Council v. Ritchie*, 402 U.S. 497 (1971). One involved plaintiffs who no longer needed the relief sought, thus rendering the case clearly moot; because the petitioners might need other relief in the future, the Court did not rest its *remand* on

mootness, but found that it should not retain the case as it was not then known that such relief would be needed. *Sanks v. Georgia*, 401 U.S. 144 (1971). Fulton Corp. in its Brief for the Petitioner at fn. 2 also cited a fourth case cited by the Secretary, *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70 (1955), pointing out that the statutory change there prevented any future plaintiff from encountering the problem encountered by the petitioner. That is not true here as current and future North Carolina plaintiffs (and Fulton Corp. in a refund action for taxes paid in other years) seeking refund of intangibles taxes paid for 1992, 1993 and 1994 will encounter as a bar the North Carolina Supreme Court decision at issue here, unless this Court acts. The Court granted its writ in *Cook v. Hudson*, 429 U.S. 165 (1976), the last case cited by the motion, in part to review the propriety of segregated private schools, which was resolved in *Runyon v. McCrary* in the interim, in contrast to the unresolved issues here.

C. Fulton and Others Will Be Entitled to Refunds.

The Secretary's motion erroneously states "petitioner and other similarly situated North Carolina taxpayers most likely would not obtain a refund even if petitioner were to prevail on the merits . . . . " This implies that the case is not of importance because no useful remedy can be forthcoming, as in *Sanks*. This is not correct. Fulton and thousands of other taxpayers will be entitled to refunds.

This Court's reversal of the Supreme Court of North Carolina will mean that Fulton paid an

unconstitutional tax and will be entitled to meaningful backward-looking relief under *Harper*, 113 S. Ct. 2510. That relief may be either refund or equality of treatment produced by requiring all taxpayers who used the discriminatory deduction for 1991 (and 1992, 1993 and 1994) to pay additional taxes resulting from loss of the deduction. The only practical way, however, to remove the discrimination under the intangibles tax on stocks will be to refund the tax.

The Secretary's argument is akin to that made by the state in *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1 (1989). In that case, the taxpayer sued for refund of tax paid for a three years period during which required it to pay sales and use tax on its magazine, but did not tax religious magazines. The taxpayer sought no prospective relief because the statute had been changed to relieve it of the tax. The state argued that the taxpayer lacked standing because no prospective remedy was needed and no refund would be allowed because the proper remedy would be to remove the exemption of religious magazines. The Court found this contention misguided as one that would "effectively insulate underinclusive statutes from constitutional challenge, ... " 489 U.S. at 8. Similarly, through its motion North Carolina would effectively insulate repealed statutes from constitutional review by this Court.

In *Texas Monthly*, in words directly applicable to the instant case, the Court said:

> It is not for us to decide whether the correct response as a matter of state law to a finding that a state tax exemption is unconstitutional is to

eliminate the exemption, to curtail it, to broaden it, or to invalidate the tax altogether. Nor does it make any difference - contrary to the State's suggestion - that Monthly seeks only a refund and not prospective relief, as did the appellant in *Arkansas Writers' Project*. A live controversy persists over Monthly's right to recover the $149,107.74 paid, plus interest. *cannot strip appellant of standing by changing the law after taking its money.* (emphasis added)

489 U.S. at 8.

CONCLUSION

A live controversy exists over whether Fulton (as well as thousands of similarly situated North Carolina taxpayers) can recover its taxes. North Carolina cannot strip Fulton of that possibility by changing the law after taking Fulton's money. The Court should deny the motion to dismiss the writ.

Respectfully submitted,
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APPENDIX

(From Statement of Facts in Brief for the Petitioner)

E. Subsequent Event. Subsequent to this Court's grant of its writ of certiorari, the North Carolina General Assembly repealed the intangibles tax for returns due in 1996. 1995 N.C. Sess. Laws Ch. 41; App. 15a. This repeal does not affect the tax year at issue in this case or Taxpayer's refund claim, which remain unsatisfied (as do the refund claims of the Taxpayer for other years for which a separate suit has been brought, and the refund claims of thousands of similarly situated North Carolina taxpayers for 1991, 1992, 1993 and 1994 taxes). Taxpayer made its refund claim under N.C. Gen. Stat. § 105-267, the only avenue allowed by the North Carolina courts for a taxpayer to contest an illegal tax. App. 14a. Therefore, the case is neither moot nor is the importance of the legal issues upon which this Court issued its writ of certiorari diminished.[3]

3

The case is not moot so long as the parties have a concrete interest in the outcome of the action, however small. *See University of v. Camenisch*, 451 U.S. 390 (1981); *Powell v. McCormack*, 395 U.S. 486, 495-500 (1969); *Ellis v. Brotherhood of Clerks*, 466 U.S. 435 (1984) (not moot where claim for damages remained); *Board of Pardons v. Allen*, 482 U.S. 369, 370 n. 1 (1987) (remaining claims for damages prevented mootness). Furthermore, the significance of the issue on which this Court granted its writ continues. The instant case is distinguishable from perhaps the classic case in which this Court discussed dismissal of a previously granted writ, wherein the state adopted a statute that precluded any future enforcement of the offensive cemetery contract terms at issue in the case, so that

similarly situated plaintiffs in any other case arising in the future would be entitled to damages. *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70 (1955). Here Fulton Corp. and other North Carolina taxpayers have pursued and can pursue refund of these illegal taxes and have been and will be denied those refunds on the basis of the decision of the Supreme Court of North Carolina in the instant case.